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A RELUCTANT STANCE BY THE INTERNAL REVENUE SERVICE: THE UNCERTAIN FUTURE OF THE USE OF THE SECTION 2503(b)¹ ANNUAL GIFT EXCLUSION FOLLOWING CRUMMEY² AND CRISTOFANI³

Pam and her husband, Nick, have decided to create an irrevocable living trust to benefit their three children and seven grandchildren. They both want to take advantage of the \$10,000 annual gift exclusion under section 2503(b) of the Internal Revenue Code.⁴ Under this section, Pam and Nick may each contribute up to \$10,000 per year (a total of \$20,000) to each trust beneficiary without gift tax consequences. Pam and Nick have named their three children as primary beneficiaries and have given their seven grandchildren contingent remainder interests in the trust. The trust agreement expressly provides that any of the three children or the seven grandchildren may withdraw funds from the trust. However, they must do so within thirty days of any trust contribution or forfeit their ability to withdraw funds from that contribution.

In 1995, 1996, and 1997, Pam and Nick transferred a combined sum of \$200,000 to the trust annually. Thus, \$20,000 had been given to each of the ten beneficiaries named in the trust (\$10,000 from Pam, \$10,000 from Nick) each year. It is now 1998, and Pam and Nick have successfully transferred a total of \$600,000 to the trust over the past three years. Each year, both Pam and Nick had claimed ten annual exclusions of \$10,000 (\$100,000 total) under section 2503(b) of the Internal Revenue Code in 1995, 1996, and 1997.

With respect to the seven grandchildren, however, the Internal Revenue Service maintains that Pam and Nick were not eligible to take advantage of the section 2503(b) annual gift exclusion in each of the past three years. Thus, the Internal Revenue Service alleges a \$210,000 deficiency in the Federal gift tax of both Pam and Nick for this three year period (a

1. I.R.C. § 2503(b) (1997).

2. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

3. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991).

4. I.R.C. § 2503(b) (1997).

total of \$420,000).⁵ *The Internal Revenue Service maintains: (1) that there is no express agreement as to whether the grandchildren could make a present demand of trust funds; (2) that the contributions to the trust do not constitute gifts of "present interest"; and (3) that Pam and Nick named the grandchildren as beneficiaries only to take advantage of the \$10,000 section 2503(b) annual gift exclusion.*

As to the seven grandchildren, should the court allow Pam and Nick to exclude \$210,000 of the \$300,000 they each transferred to the trust between 1995 and 1997? Or, is the Internal Revenue Service justified in disallowing the section 2503(b) annual gift exclusions? Considering the Internal Revenue Service's unwillingness to accept the reasoning behind the "Crummey power"⁶ and its recent indication that future use of section 2503(b) will be challenged, the answers are uncertain.

I. INTRODUCTION

Under the decision in *Crummey v. Commissioner*,⁷ individual taxpayers may make valid inter vivos⁸ gift transfers using the \$10,000 annual gift tax exclusion under section 2503(b) of the Internal Revenue Code. The only limitation on this taxpayer benefit is that contingent beneficiaries named in the trust must have either the present "right to enjoy" or a legal right to the trust property.⁹ Using the *Crummey* with-

5. To clarify, Pam and Nick transferred a combined total of \$20,000 for each of the ten beneficiaries of the trust ($\$20,000 \times 10 = \$200,000$). With respect to the seven grandchildren, Pam and Nick each claimed an annual gift exclusion of \$70,000 three years in a row ($(7 \text{ grandchildren} \times \$10,000) \times 3 \text{ years} = \$210,000$). This represents the \$210,000 deficiency alleged by the IRS for both Pam and Nick (a \$420,000 total).

6. The term "Crummey power" originated from the *Crummey v. Commissioner of Internal Revenue* decision. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968). "Crummey power" refers to a strategy in which annual exclusions are granted for gifts of property made to primary and contingent beneficiaries through an irrevocable trust. Owen J. Fiore & John F. Ramsbacher, *Crummey Powers for Contingent Beneficiaries OK'd*, EST. PLANNING, Jan. 1992, at 10.

7. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

8. "Between the living; from one living person to another . . . an ordinary gift from one person to another . . . to distinguish it from a gift made in contemplation of death or a testamentary gift." BLACK'S LAW DICTIONARY 821 (6th ed. 1990).

9. In determining whether the gift is one of "present interest," emphasis should be placed on the donee's right to enjoy the gift rather than actual enjoy-

drawal power and a lenient interpretation of section 2503(b),¹⁰ a greater amount of an individual taxpayer's wealth may be transferred to his or her family.¹¹ Inter vivos transfers among family members based on the *Crummey* withdrawal power can serve as a beneficial element of family estate planning.¹²

The creation of a trust arrangement as a medium for inter vivos transfers provides several benefits to the donor.¹³ First, the donor is able to retain significant control over which individuals are named in the trust and the amount of property or money that is annually contributed to it.¹⁴ Second, inter vivos transfers by way of a trust arrangement may have the effect of minimizing the donor's tax liability.¹⁵ Before 1996, a donor taxpayer could use section 2503(b), as interpreted through the *Crummey*¹⁶ and *Estate of Cristofani v. Commissioner*¹⁷ decisions, to annually exclude \$10,000 from federal gift tax for each beneficiary named in the trust.¹⁸ However, in 1996, the Service issued Technical Advisory Memorandum 9628004¹⁹ which suggests that taxpayer ability to use section 2503(b) may be more heavily scrutinized.²⁰ Consequently, it is of great importance that identifiable requirements regarding use of the section 2503(b) annual exclusion are established to ensure donor taxpayers lawfully employ section 2503(b).²¹

Proponents of the *Crummey* power assert that there is only one limitation that the Internal Revenue Service ("Internal Revenue Service" or "Service") places on the use of the section 2503(b) gift exclusion—that the gift cannot be one

ment of the gift. *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118, 121 (7th Cir. 1951).

10. See discussion *infra* Part II.A.

11. Fiore & Ramsbacher, *supra* note 7, at 10.

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

17. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991).

18. See discussion *infra* Part II.B-C.

19. Tech. Adv. Mem. 9628004 (July 30, 1996).

20. See discussion *infra* Part II.E.

21. See discussion *infra* Part V.

of a future interest.²² However, because the definition of a future interest offered by the Service is so complex, there has been significant controversy in determining whether trust contributions are considered gifts of a present interest or gifts of a future interest.²³ In analyzing whether a taxpayer can use the section 2503(b) exclusion, different standards have developed for determining whether a gift of a present interest has been made.²⁴

The most prominent standard to determine whether a gift of a present interest has been made is the "right to enjoy" or legal right test.²⁵ The "right to enjoy" or legal right test employed by the Ninth Circuit in *Crummey*²⁶ and the tax court in *Cristofani*²⁷ mandates that the beneficiary have an unrestricted legal right to make a present demand of trust property in order for the taxpayer to take advantage of the section 2503(b) annual exclusion.²⁸ An alternative to the "right to enjoy" or legal right test is the "summation of the factors" test.²⁹ The "summation of the factors" test focuses on a multitude of factors, including the language of the trust agreement, the age of the beneficiaries, the intent of the donor in creating the trust, and the circumstances surrounding the formation of the trust, to determine whether a taxpayer

22. The tax regulations define "future interest" for the purposes of section 2503(a) as follows:

(a) No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the "calendar period". "Future interest" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift.

Treas. Reg. § 25.2503-3 (1997).

23. See discussion *infra* Part IV.B.

24. See discussion *infra* Parts IV.B.1.a-c, IV.B.2.

25. See discussion *infra* Part II.D.2.

26. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

27. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991).

28. See discussion *infra* Part IV.B.1.a-c.

29. See discussion *infra* Part II.D.4.

can utilize the section 2503(b) annual exclusion.³⁰

In publishing its Technical Advisory Memorandum ("TAM") 9628004,³¹ the Service has indicated that it intends to challenge the current application of the section 2503(b) annual gift exclusion as interpreted in the *Crummey* decision.³² The Internal Revenue Service has supported its current interpretation of the section 2503(b) annual gift exclusion via the *Crummey* power by arguing "substance over form."³³ When determining whether the section 2503(b) annual gift exclusion has been lawfully used, the Service asserts that the "substance" rather than the "form" of a trust arrangement employing section 2503(b) via the *Crummey* power should control.³⁴ By challenging the use of the section 2503(b) annual gift exclusion in certain situations,³⁵ the Service is attempting to eradicate any type of taxpayer abuse to which section 2503(b) might be subjected.³⁶

While the Service's concern about taxpayer abuse of section 2503(b) through the *Crummey* power is understandable, current standards for determining lawful use of the section 2503(b) annual gift exclusion remain inadequate. As such, specific legislative guidelines created according to the decisions in *Crummey* and *Cristofani* must be developed to ensure proper taxpayer use of the section 2503(b) annual gift exclusion.³⁷

Specifically, this comment will focus on the Service's continued adherence to the *Crummey* interpretation of the section 2503(b) annual gift exclusion. Support for this interpretation of section 2503(b) is based on factors such as the beneficiaries' awareness of the ability to demand trust property,³⁸ the advantage of the "legal right" standard in determining present interest,³⁹ and different policy considerations supporting the *Crummey* interpretation of the section 2503(b) annual gift exclusion.⁴⁰ Thus, the objective of this comment is

30. See discussion *infra* Part IV.B.2.

31. Tech. Adv. Mem. 9628004 (July 30, 1996).

32. See discussion *infra* Part II.E.1.

33. Tech. Adv. Mem. 9628004 (July 30, 1996).

34. *Id.*

35. See discussion *infra* Part II.E.1.

36. See discussion *infra* Part IV.C.2.

37. See discussion *infra* Part V.

38. See discussion *infra* Part IV.A.

39. See discussion *infra* Part IV.B.1-3.

40. See discussion *infra* Part IV.C.

to propose model legislation in order ensure that the interpretation of section 2503(b) stays faithful to the factors highlighted above.

Accordingly, this comment is organized as follows. Part II, the background section, will trace the development of the courts' interpretation of the annual gift exclusion, concluding with the present uncertainty created by the Service concerning taxpayer use of section 2503(b).⁴¹ Part III outlines the legal issue that has been created by the Service's new position regarding the leveraged use of the section 2503(b) annual gift exclusion by way of the *Crummey* power.⁴² Part IV, the analysis section, illustrates the need for legislative guidelines to eliminate taxpayer confusion regarding the Service's current position regarding section 2503(b).⁴³ Finally, Part V proposes legislative guidelines to serve as a framework for proper taxpayer use of the section 2503(b) annual gift exclusion.⁴⁴ This proposed legislation aims to reduce the possibility of future tax litigation regarding a taxpayer's use of section 2503(b).

II. BACKGROUND

A. *Section 2503(b) of the Internal Revenue Code: An Introduction*

The Internal Revenue Service allows a donor taxpayer to exclude the first \$10,000 of any gift made to a donee during the calendar year in which the gift is made.⁴⁵ The provision allowing the donor taxpayer to take the \$10,000 annual gift exclusion is section 2503(b).⁴⁶ Section 2503(b) of the Internal Revenue Code provides:

In the case of gifts (other than gifts of a future interests in property) made to any person by the donor during the calendar year, the first \$10,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in

41. See discussion *infra* Part II.

42. See discussion *infra* Part III.

43. See discussion *infra* Part IV.

44. See discussion *infra* Part V.

45. I.R.C. § 2503(b) (1997).

46. *Id.*

property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.⁴⁷

Donors invoking the use of the *Crummey* power to take advantage of the taxpayer benefits under section 2503(b) are attempting to apply the \$10,000 annual gift exclusion to both present and contingent beneficiaries created through an irrevocable trust.⁴⁸ The language of section 2503(b) states no limitation on the number of exclusions a donor may take when contributing to an irrevocable trust, as long as the donor has not given a gift of a future interest.⁴⁹ From a textual standpoint, a donor who has named numerous beneficiaries to the income or corpus of the trust has the capability of excluding a large proportion of any contribution made to the trust.⁵⁰

B. "Crummey" Powers: *An Application of the Section 2503(b) Annual Gift Exclusion*

In 1968, the Ninth Circuit Court of Appeals decided *Crummey v. Commissioner*.⁵¹ *Crummey* involved the creation of an irrevocable living trust by the trustor parents for the benefit of their four children.⁵² Each trustor parent filed a separate gift tax return for each year in which money was contributed to the trust.⁵³ Of specific importance, language in the trust agreement indicated that each child named in the

47. *Id.* The donor taxpayer is able to exclude a greater portion of any trust contribution from federal gift tax by naming a greater number of individuals as beneficiaries to the trust. *Id.*

48. Fiore & Ramsbacher, *supra* note 7, at 10.

49. I.R.C. § 2503(b) (1997).

50. *Id.*

51. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

52. *Id.* at 83-87.

53. *Id.* at 83. The primary dispute revolved around the tax years of 1962 and 1963. *Id.* On December 31, 1962, the respective ages of the beneficiaries were as follows: John Knowles Crummey, 22; Janet Sheldon Crummey, 20; David Clarke Crummey, 15; Mark Clifford Crummey, 11. *Id.* at 82. On December 31, 1963, the respective ages of the beneficiaries were as follows: John Knowles Crummey, 23; Janet Sheldon Crummey, 21; David Clarke Crummey 16; Mark Clifford Crummey, 12. *Id.* The original contribution to the trust was \$50.00. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 82 (9th Cir. 1968). Subsequent contributions to the trust were as follows: \$4,267.77 on June 20, 1962; \$49,550.00 on December 15, 1962; \$12,797.81 on December 19, 1963. *Id.* at 83.

trust had the present ability to demand an immediate cash withdrawal from the trust.⁵⁴

Focusing on the issue of whether or not the trustors gave a present interest to their minor children so as to qualify for the section 2503(b) exclusion,⁵⁵ the Ninth Circuit concluded that postponed enjoyment is not equivalent to a "future interest" if the postponement is caused solely by the minority of the beneficiary.⁵⁶ Employing the "*Perkins* Test,"⁵⁷ the *Crummey* court held that a demand on the trust funds by *any* of the beneficiaries may not be resisted and, thus, all contributions to the trust were gifts of a present interest.⁵⁸ As a result, the parent trustors were allowed all the section 2503(b) exclusions for the two-year period in which they had contributed to the trust.⁵⁹ The Ninth Circuit came to the conclusion that, under these circumstances, each named beneficiary of the trust had the present ability to demand funds from the trust.⁶⁰

54. The relevant language of the "demand" provision of the trust agreement stated:

With respect to such additions, each child of the trustors may demand at any time (up to and including December 31 of the year in which a transfer to his or her Trust has been made) the sum of Four Thousand Dollars (\$4,000.00) or the amount of the transfer from each donor, whichever is less, payable in cash immediately upon receipt by the Trustee of the demand in writing and in any event, not later than December 31 in the year in which such transfer was made. Such payment shall be made from the gift of that donor for that year. If a child is a minor at the time of such gift of that donor for that year, or fails in legal capacity for any reason, the child's guardian may make such demand on behalf of the child.

Id.

55. *Id.* at 83-84.

56. *Id.*

57. *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601 (1956). The tax court in *Perkins* concluded a contribution to a trust will be considered a gift of a present interest as long as any present demand of trust property by a beneficiary may not be legally resisted. *Id.* at 606.

58. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 88 (9th Cir. 1968).

59. *Id.*

60. *Id.* at 87. First, a beneficiary demands her share of the trust property. *See id.* If a minor, the trustee would petition the court for the appointment of a legal guardian and then turn the funds over to the guardian. *Id.* The parent might also be able to make the demand as the natural guardian. *Id.* This, however, would involve the acquisition, rather than management, of the trust property. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 87 (9th Cir. 1968). If the property was acquired, the appointment of a legal guardian to take charge of the funds would be necessary. *Id.*

The Internal Revenue Service asserted that the section 2503(b) gift exclusion should apply only to those beneficiaries who were most likely to make an effective demand of funds from the trust.⁶¹ Although conceding that those beneficiaries who were not of majority did have "paper rights" to the trust funds,⁶² the Service argued that the minor beneficiaries lacked the capacity to appoint an agent to make a demand on the trust funds or to sue if a question arose as to the beneficiaries' legal right to the trust funds.⁶³ Taking the above arguments into account, the *Crummey* court reasoned that it would be arbitrary and unfair to enable the Service to decide which beneficiaries will or will not be likely to make an effective demand of the trust funds.⁶⁴

C. *The Impact of Cristofani: An Extension of the Crummey Power*

In 1991, the tax court rendered a unanimous decision in *Estate of Cristofani v. Commissioner*.⁶⁵ *Cristofani* involved a decedent who had created an irrevocable inter vivos trust to which she contributed property two years before her death.⁶⁶ The primary beneficiaries of the trust were the decedent's two children, while the decedent's five grandchildren held contingent remainder interests in the trust.⁶⁷ A provision in the trust provided that both the primary and contingent beneficiaries had the unrestricted right to withdraw an amount from the trust not to exceed the amount of the an-

61. *Id.* at 89.

62. *Id.* at 87.

63. *Id.* It should be noted that the beneficiary petitioners attempted to refute the above argument by asserting that all minors above the age of 14 had the ability to make a demand on the trust because they had the capacity to appoint a legal guardian. *Id.* The petitioners also argued that, as natural guardians, their parents (trustors) had the ability to make a demand of the trust funds (for the beneficiaries) by appointing a legal guardian to receive the property. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 87 (9th Cir. 1968).

64. *Id.* at 87-88. The court found nothing to indicate that it was any more likely that a twenty-three year old beneficiary would demand trust funds than any of the younger beneficiaries. *Id.* at 88. Although it may be easier for an older beneficiary to make a demand for the trust funds, none of the four children could be resisted in their demand for trust funds. *Id.*

65. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991).

66. *Id.* at 75.

67. *Id.*

nual gift tax exclusion.⁶⁸

At the time the will was executed, the primary beneficiaries (parents) were the legal guardians of their respective minor children and there was no indication of independently appointed guardians of the contingent beneficiaries' (children) property.⁶⁹ Furthermore, the decedent had signed a power of attorney that named the primary beneficiaries of the trust as the decedent's attorneys in fact.⁷⁰

The decedent had intended to fund the corpus⁷¹ of the trust with 100% ownership of improved real property that was to be transferred into the trust during each of three taxable years.⁷² In accordance with her original intent, the decedent transferred a 33% interest to the trust via quitclaim deed recorded in 1984, and a second 33% interest in the property, also through quitclaim deed, in 1985.⁷³ The decedent intended to transfer the final 33% interest in the property to the trust in 1986.⁷⁴ However, prior to the transfer, the decedent died and the remaining 33% interest in the property remained in her estate.⁷⁵

The decedent failed to report the two \$70,000 transfers on her Federal gift tax return.⁷⁶ Instead, the decedent

68. *Id.* at 75-76. "Article Twelfth" of the trust mandated that, following a contribution to the trust, either of the primary beneficiaries has the power to withdraw an amount not to exceed the amount specified under the section 2503(b) gift tax exclusion (\$10,000) within fifteen days of each contribution. *Id.* "Article Twelfth" also stated that each of the contingent beneficiaries possessed the same right of withdrawal as the primary beneficiaries. *Id.* at 76. In addition, "Article Third" stated that the trustees, in their discretion, could apply as much of the principal of the trust as necessary for the proper support, health, maintenance, and education of the primary beneficiaries. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 76 (1991). In exercising their discretion, the trustees were to take into account several factors, which included the "settlor's desire to consider the primary beneficiaries of primary importance and the contingent beneficiaries of secondary importance." *Id.*

69. *Id.* at 75-76.

70. *Id.* at 75.

71. "Corpus" is defined as the "principal sum or capital" of the trust. BLACK'S LAW DICTIONARY 343 (6th ed. 1990).

72. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 77 (1991). The sole piece of property in question was a lot containing a warehouse, which the court entitled the "Spring Street property." *Id.*

73. *Id.*

74. *Id.*

75. *Id.* Each of the two prior transfers of property were valued at \$70,000 at the time of the transfer. *Id.*

76. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 77 (1991).

claimed seven annual \$10,000 exclusions under section 2503(b) for each year in which an interest in property was transferred to the trust.⁷⁷ Although allowing the decedent to claim the annual exclusions with respect to her two children, the Service disallowed the exclusions claimed with respect to each of the decedent's five grandchildren. The Service claimed that the transfers with respect to the decedent's five grandchildren were not transfers of a present interest in the property.⁷⁸

Distinguishing *Crummey*,⁷⁹ the Service asserted that in *Crummey* the trust beneficiary children possessed both the immediate power of withdrawal and the future benefit in the trust corpus and income.⁸⁰ In the instant case, the Service argued that language contained in the trust documents indicated that the decedent had intended her two children to be the primary beneficiaries while her grandchildren were considered beneficiaries of secondary importance.⁸¹ In holding for the decedent, the *Cristofani* court interpreted *Crummey*⁸² to mean that beneficiaries of a trust do not need a vested present interest or vested remainder interest in the trust corpus or income in order to qualify for the section 2503(b) exclusion.⁸³ Disregarding a standard that focused on the likelihood that the beneficiaries would exercise their right to the trust funds, the *Cristofani* court focused on the legal ability of the beneficiary to withdraw property from the trust.⁸⁴ The *Cristofani* court concluded that each grandchild possessed

77. *Id.* at 75-77 (1991). Decedent claimed an exclusion for each of her two children as well as for each of her five grandchildren and, as a result, the decedent was able to exclude the entire value of the transferred property from federal gift tax in 1984 and 1985. *Id.*

78. *Id.* at 77. The Internal Revenue Service disallowed the exclusions for both 1984 and 1985. *Id.* As a result, the Internal Revenue Service increased the decedent's adjusted taxable gifts from \$70,000 to \$100,000. *Id.* at 78.

79. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

80. *Id.* at 87-88.

81. *Cristofani*, 97 T.C. at 88. "Article Third" of the trust indicated that the trustees could apply as much of the principal of the trust as necessary to take care of the decedent's children. *Id.* In exercising their discretion, the trustees were to take into account different factors, including "the Settlor's desire to consider the Settlor's children as primary beneficiaries and the other beneficiaries of secondary importance." *Id.*

82. *Id.* at 88.

83. *Id.* at 80-83.

84. *Id.*

the legal right to withdraw funds from the trust and the appointed trustees could not legally resist a withdrawal demand by any of the grandchildren.⁸⁵

Additionally, the Service argued that because the grandchildren possessed only a contingent remainder interest in the trust, the decedent only intended to benefit her two children as primary beneficiaries and not her grandchildren as contingent beneficiaries.⁸⁶ However, solidifying its decision to allow the section 2503(b) exclusion for the grandchildren, the *Cristofani* court determined that provisions in the trust and the grandchildren's ability to withdraw funds from the trust for a limited period of time indicated that the decedent intended to benefit her grandchildren.⁸⁷

D. *Differing Standards Used to Determine Whether a Trust Contribution May Be Considered a Gift of a "Present Interest"*

1. *The General Requirement: Contributions to a Trust Must Be a Gift of a Present Interest*

Under section 2503(b), a donor may only take the annual \$10,000 gift exclusion if the contribution is a gift of a present interest.⁸⁸ A contribution to a trust is considered a gift of a present interest only if the beneficiary for whom the contribution has been made is not limited as to when he or she may enjoy the trust property.⁸⁹ In accordance with the section 2503(b) requirement that a gift of a present interest be made, several different standards have been employed to determine

85. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 81-83 (1991).

86. *Id.*

87. *Id.* As remaindermen, the grandchildren's benefits were contingent upon one of the primary beneficiaries dying before the decedent died or failing to survive the decedent by more than 120 days. *Id.* Although both primary beneficiaries were in good health at the time the trust was executed, the court indicated that the possibility existed that the primary beneficiaries could predecease the decedent. *Id.* at 80-83. Regarding the grandchildren's present ability to withdraw funds from the trust, the *Cristofani* court focused on the grandchildren's present ability to withdraw funds from the trust up to the amount allowable by the section 2503(b) exclusion. *Id.* Although the grandchildren never exercised the right to withdraw, it did not negate the fact that they did have the right to do so within fifteen days following a contribution to the trust by the decedent. *Estate of Cristofani*, 97 T.C. at 80-83.

88. I.R.C. § 2503(b) (1997).

89. Treas. Reg. § 25.2503-3 (1997).

what constitutes a gift of a present interest.⁹⁰

2. Current Standard

The current standard used to determine whether a contribution to a trust may be considered a gift of a present interest is whether the beneficiaries have a legal right to make a present demand of the trust property.⁹¹ The *Crummey*⁹² and *Cristofani*⁹³ decisions set out certain criteria to determine whether a gift of a present interest has been made. Relying on the *Perkins* Test⁹⁴ and “right to enjoy” standard established in *Gilmore v. Commissioner*,⁹⁵ the Ninth Circuit in *Crummey* concluded that all beneficiaries to the trust had the legal right to make an unrestricted, present demand of trust property.⁹⁶ The *Crummey* court set forth the “right to enjoy” and legal right tests as follows:

All exclusions should be allowed under the *Perkins* test or the “right to enjoy” test in *Gilmore*. Under *Perkins*, all that is necessary is to find that the demand could not be resisted. We interpret that to mean legally resisted and, going on that basis, we do not think the trustee would

90. See discussion *infra* Part II.D.2-4.

91. See, e.g., *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968); *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601 (1956).

92. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 88 (9th Cir. 1968).

93. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 82, 83 (1991).

94. *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601 (1956). The tax court in *Perkins* concluded a contribution to a trust will be considered a gift of a present interest as long as any present demand of trust property by a beneficiary may not be legally resisted. *Id.* at 606.

95. *Gilmore v. Commissioner of Internal Revenue*, 213 F.2d 520 (6th Cir. 1954). In *Gilmore*, the Sixth Circuit indicated that a contribution to a trust will be considered a gift of a present interest as long as the trust instrument indicates that the beneficiary has the “right to enjoy” all income from the trust. *Id.* at 521-22.

96. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 88 (9th Cir. 1968). The Ninth Circuit rejected the argument that a gift of a present interest should be determined by who was most likely to make a present demand of trust funds. *Id.* Although admitting that it would be easier for some beneficiaries to make a demand for the trust funds, the *Crummey* court concluded that all beneficiaries could make an unresisted, present demand of trust property. *Id.* As a result, the contributions to the trust were considered to be gifts of a present interest allowing the donor to take the section 2503(b) annual gift exclusion. *Id.*

have had any choice but to have a guardian appointed to take the property demanded.⁹⁷

In allowing the donor to take the section 2503(b) annual gift exclusion, the Ninth Circuit followed the legal right doctrine, reasoning that it would be arbitrary and unfair for the Internal Revenue Service to subjectively decide which donees were likely to make a present demand of trust property.⁹⁸

In *Cristofani*, the tax court also adhered to the legal right doctrine developed in *Perkins* and *Gilmore* and used by the Ninth Circuit in *Crummey*.⁹⁹ The tax court concluded that both the language of the trust instrument and the stipulations of the parties dictated that each beneficiary to the trust "possessed the legal right to withdraw trust corpus and that the trustees would be unable to legally resist a [grandchild's] withdrawal demand."¹⁰⁰ As in *Crummey*, the donor in *Gilmore* was able to take the section 2503(b) annual exclusion for each of the named beneficiaries of the trust.¹⁰¹

The intended beneficiaries in *Gilmore*, as in the *Cristofani* case, were all of minority status ranging from age one to age seven.¹⁰² The trust instrument in *Gilmore* provided that the trustee shall pay the income from the trust to the grandchildren as named beneficiaries of the trust.¹⁰³ Furthermore, the trust instrument also indicated that if any of the grandchildren were to die, the trust would terminate, and the remaining trust property would be paid to the estate of the beneficiaries.¹⁰⁴ Rejecting an assertion by the tax court that the beneficiaries' right to the income was contingent on the trustee's willingness to invest the corpus of the trust, the

97. *Id.* at 88.

98. *Id.* at 87-88.

99. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 83 (1991).

100. *Id.*

101. *Id.* at 84-85.

102. *Gilmore v. Commissioner of Internal Revenue*, 213 F.2d 521 (6th Cir. 1954). In *Gilmore*, the donor made gifts of corporate stock through the creation of trusts for her seven grandchildren. *Id.* at 520.

103. *Id.* at 520. The trust instrument in *Gilmore* specifically provided that:

Trustee shall pay the principal and all income from the trust estate to [the named beneficiary] upon demand by the said [beneficiary], and in case of his death this trust will terminate and all of the remaining principal and accumulated income therefrom shall be paid to the estate of the said [beneficiary].

Id. at 520-21.

104. *Id.*

Sixth Circuit determined that each trust instrument gave every named beneficiary an absolute "right to enjoy" all income from the trust.¹⁰⁵ As a result, the contributions to the trust were deemed to be gifts of a present interest and the donor was allowed to take the section 2503(b) annual exclusion.¹⁰⁶

Nearly identical to the facts in *Gilmore*, the *Perkins* case involved a gift of corporate stock for the benefit of the donor's seven minor grandchildren.¹⁰⁷ The donor had created the trusts for the purpose of providing educational funds for his grandchildren.¹⁰⁸ However, the trustees were given the unfettered ability to distribute income from the trust at their discretion.¹⁰⁹

Similar to the courts' determinations in *Cristofani* and *Gilmore*, the *Perkins* court concluded that at the time contributions were made to the trust, each of the seven beneficiaries were not sufficiently mature to make a reasoned, effective demand for the distribution of income from the trusts, or to move to terminate the trusts.¹¹⁰ In holding that a gift of a present interest has been made as long as the intended beneficiary cannot be legally resisted from making a present demand for the trust property,¹¹¹ the court focused on the lan-

105. *Id.* at 521-22. The tax court argued that a provision in the trust granted the trustees general investment powers. *Gilmore v. Commissioner of Internal Revenue*, 213 F.2d 521, 521-22 (6th Cir. 1954). Because the trustees could use their discretion as to which investments would be in the best interests of the beneficiaries, the tax court asserted that the beneficiaries' right to income was contingent on the willingness of the trustees to invest the corpus of the trust in such a manner that income would result from the investment. *Id.* at 522. Thus, according to the tax court, the beneficiaries' right to enjoy the trust property was contingent on the trustees investment discretion, which could not be classified as a present right to enjoy the trust property. *Id.*

106. *Id.* at 521-22.

107. *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601, 602 (1956). A separate irrevocable trust was created for each of the donor's seven grandchildren. *Id.* The trust agreements were identical, except for the names of the beneficiaries and trustees. *Id.*

108. *Id.* at 603.

109. *Id.* at 603. This is similar to the situation in *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118 (7th Cir. 1951). See discussion *infra* Part II.D.3. However, *Perkins* may be distinguished from *Kieckhefer* in that each trust in *Perkins* was to continue only until the beneficiary reached the age of twenty-five. *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601, 603 (1956). When each beneficiary reached the age of twenty-five, the trust was to terminate and all of the principal was to be paid over to the beneficiary. *Id.*

110. *Id.* at 604.

111. *Id.* at 606.

guage of the trust instrument.¹¹² The trust instrument indicated that the beneficiary may demand all of the principal and income from the trust at any time.¹¹³

3. *Concerns with the Application of the Current Standard*

Five years prior to *Perkins*, a Seventh Circuit decision, *Kieckhefer v. Commissioner*,¹¹⁴ illustrated a potential concern with the "right to enjoy" or legal right standard.¹¹⁵ In *Kieckhefer*, the donor grandparent created a trust for the benefit of his minor grandson in which the donor's son was named trustee.¹¹⁶ The trust instrument, as in *Perkins*, provided that distributions on behalf of the beneficiary's education, comfort, and support were at the discretion of the trustee.¹¹⁷ Article Thirteen of the trust specifically provided that the beneficiary may demand, either through his individual capacity or through a legally appointed guardian, all or any part of the trust property.¹¹⁸ Although the trustee was given the power

112. *Id.* at 605-06.

113. *Id.* at 604. Each trust instrument provided "that notwithstanding all other provisions, the beneficiary, his duly appointed guardian, or his parent may at any time demand and receive all of the income and principal." *Id.* at 604.

114. *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118 (7th Cir. 1951).

115. *Id.* at 122.

116. *Id.* at 119. The trustee, as the father of the beneficiary, was financially capable of supporting and educating his son (beneficiary) without the assistance of trust funds. *Id.*

117. "Article Fifth" of the trust instrument provided: "The trustee shall pay to the beneficiary or apply on his behalf such income from the trust and so much of the principal thereof as may be necessary for the education, comfort, and support of the beneficiary and shall accumulate for such beneficiary all income not so needed." *Id.* at 119.

118. "Article Thirteenth" stated:

This trust has been created by the donor after full consideration and advice. Upon such consideration and advice the donor has determined that this said trust shall not contain any right in the donor to alter, amend, revoke or terminate it. The beneficiary shall be entitled to all or any part of the trust estate or to terminate the trust estate in whole or in part at any time whenever said John Irving Kieckhefer or the legally appointed guardian for his estate shall make due demand therefore by instrument in writing filed with the then trustee and upon such demand being received by the trustee the trustee shall pay said trust estate and its accumulations, or the part thereof for which demand is made, over to said John Irving Kieckhefer or to the legally appointed guardian for his estate who made such demand on his behalf.

Id. at 119-20.

to distribute trust property at his discretion, the Seventh Circuit held that the contribution to the trust was a gift of a present interest because the beneficiary had the unconditional right to presently use, possess, or enjoy the trust property.¹¹⁹

The *Kieckhefer* court asserted that, in addition to the beneficiary having a legal vested right to make a demand of trust property, the beneficiary must also have the present ability to enjoy or possess the trust property if a contribution to a trust is to be considered a gift of a present interest.¹²⁰ Because *Kieckhefer* dealt with the legal right of minor beneficiaries to demand trust property, the court focused its discussion of the general right of minors to make a present demand of trust property.¹²¹ While mandating that the beneficiary have the present ability to enjoy or possess the trust property, in addition to meeting the "vested, legal right" requirement, the Seventh Circuit differentiated between restrictions or contingencies that might dispossess a minor beneficiary of the present ability to enjoy or possess trust property.¹²² The *Kieckhefer* court stressed that restrictions and/or contingencies that are imposed by the donor must be distinguished from restrictions and/or contingencies which are always associated with minor beneficiaries.¹²³

It may be concluded from the Seventh Circuit's analysis in *Kieckhefer* that, in addition to the beneficiary having a legal, vested right in the trust property, the beneficiary must also have the present ability to enjoy the trust property for the taxpayer to benefit from section 2503(b).¹²⁴ If the donor or trust instrument places a restriction on the beneficiary's ability to presently enjoy trust property, then any contribution to the trust will be considered a gift of a future interest and the section 2503(b) annual gift exclusion may not be used.¹²⁵ Conversely, a natural restriction or contingency¹²⁶ on

119. *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118, 122 (7th Cir. 1951).

120. *Id.* at 121-22.

121. *Id.* at 119. *Kieckhefer* involved a \$3,000 trust contribution by a donor grandparent to a trust for the benefit of his minor grandchild. *Id.*

122. *Id.* at 122.

123. *Id.* at 121-22.

124. *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118, 122 (7th Cir. 1951).

125. *Id.*

126. *Id.* A natural contingency may include the inability of a minor benefi-

the beneficiary's ability to presently enjoy trust property will not serve to recharacterize what would normally be considered a gift of a present interest into a gift of a future interest.¹²⁷ In this circumstance, the donor may take advantage of the section 2503(b) annual gift exclusion via the *Crummey* power.

4. *An Alternative Standard for Determining Whether a Contribution to a Trust May Be Considered a Gift of a Present Interest*

Not all courts have followed the legal right or "right to enjoy" test.¹²⁸ Instead, some courts have focused on the summation of several different factors to determine if a contribution to a trust is a gift of a present interest rather than making the determination based solely on whether the beneficiary has a legal right to make a present demand of trust property.¹²⁹ The Second Circuit decision in *Stifel v. Commissioner*¹³⁰ illustrates one court's analysis of various factors to determine whether a gift of a present interest has been made.¹³¹

Stifel involved a donor who had set up three separate irrevocable trusts for his beneficiary children.¹³² Each of these three trusts provided that the trustee had discretion with regard to the distribution of trust funds for the benefit of the beneficiaries.¹³³ Furthermore, the trust instrument indicated that the trust may be terminated at any time by a beneficiary, or her legally appointed guardian, if the beneficiary is

ary to demand trust property because of his or her age. *Id.* The law mandates that a minor may not exercise specific rights without the appointment of a legal guardian. *Id.*

127. *Id.*

128. See, e.g., *Stifel v. Commissioner of Internal Revenue*, 197 F.2d 107, 110-11 (2d Cir. 1952).

129. *Id.* at 110-11.

130. *Id.*

131. *Id.*

132. *Id.* at 108.

133. *Id.* "Article Second" of the trust instrument stated:

Trustee may at any time apply to the use of the Settlor's said daughter so much of the principal of the trust, and at such time or times, as the Trustee, in its discretion, may deem necessary or advisable to provide for her proper education, medical care, living expenses and financial obligations, after giving full consideration to her age, health, abilities or limitations, other financial resources, and economic and social station in life.

Stifel, 197 F.2d at 108.

still of minority.¹³⁴

In concluding that the beneficiaries had received a gift of a future interest, the Second Circuit looked at several factors, such as the age of the beneficiary, whether a guardian had been appointed, and what the donor's purpose had been in creating the trust.¹³⁵ The *Stifel* court determined that because the beneficiaries were minors, they could only make an effective demand on the trust property through a legal guardian.¹³⁶ At the time of trial, no guardian for the beneficiaries had ever been appointed.¹³⁷ Furthermore, the donor indicated that he had set up the trust with the express purpose of teaching the beneficiaries how to invest their money.¹³⁸ As a result, the Second Circuit concluded that the contributions to the trust were gifts of a future interest and, consequently, disallowed the use of the section 2503(b) annual gift exclusion.¹³⁹

E. *The Internal Revenue Service's Current Treatment of the Use of the Section 2503(b) Annual Gift Exclusion*

1. *Substance over Form*

Following the unanimous *Cristofani* decision in 1991, the Service announced that it would deny the exclusions via *Crummey* power in circumstances where the substance of the transfer indicates only an intention to gain the benefit of the

134. *Stifel v. Commissioner of Internal Revenue*, 197 F.2d 107, 109 (2d Cir. 1952). "Article Eleventh" of the trust instrument stated:

The Settlor's daughter . . . shall have the right (which may be exercised during her minority by her general guardian, if any, or by any special guardian appointed for such purpose by a court of competent jurisdiction, but in no event by the Settlor) at any time to terminate this trust either in whole or in part, and during minority to demand payment of all or any part of any unexpended income, in which event such part or all of the principal of the trust, or any accumulated income of the trust, as to which the trust is so terminated, or such part or all of the income so demanded, as the case may be shall be paid over to the Settlor's said daughter, or, if she be a minor, to her general guardian or to such special guardian, but in no event to the Settlor.

Id.

135. *Id.* at 110-11.

136. *Id.*

137. *Id.* at 110.

138. *Id.*

139. *Stifel*, 197 F.2d at 110-11.

section 2503(b) annual gift exclusion.¹⁴⁰ Specifically, if the fact situation indicates that the substance of the transfers is merely to obtain annual exclusions and no bona fide gift of a present interest is intended, the Service stated through AOD 1996-010 that it would deny any *Crummey* exclusions, regardless of the power holder's other interests in the trust.¹⁴¹ The Service's recent challenge of the use of the *Crummey* power may occur only in selective circumstances.¹⁴² In response to several egregious trust arrangements which sought the use of the *Crummey* power, the Service published Technical Advisory Memorandum ("TAM") 9628004.¹⁴³ TAM 9628004 described the circumstances under which the *Crummey* power would be challenged.¹⁴⁴ This advisory memorandum announced:

[W]here nominal beneficiaries enjoy only discretionary income interests, remote contingent rights to the remainder, or no rights whatsoever in the income or remainder, their non exercise [of withdrawal rights] indicates that there was some kind of prearranged understanding with the donor that these rights were not meant to be exercised or that their exercise would result in undesirable consequences or both. [Based on the specific facts of the trust arrangement,] we conclude that as part of a prearranged understanding, all of the beneficiaries knew that their rights were paper rights only, or that exercising them would result in unfavorable consequences. There is no other logical reason why these individuals would choose not to withdraw \$10,000 a year as a gift which would not be includable in their income or subject the Donor to gift

140. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991), *acq. in result* 1992-1 C.B. 1.

141. *Id.*

142. Jefferey Pennell, *It's Open Hunting Season for Crummey Withdrawal Rights, Again*, 17 WEALTH TRANSFER TAX DEV. 1, 19-21 (1996).

143. Tech. Adv. Mem. 9628004 (July 12, 1996).

144. Pennell, *supra* note 142, at 20. The trust arrangements which caused the government to issue TAM 9628004 were much more extreme than the fact situation in either *Cristofani* or *Crummey*. *Id.* In these trust arrangements, the power holders were remote descendants or spouses of remote descendants. *Id.* There was no requirement that the trustee give notice to the beneficiaries of their *Crummey* withdrawal rights or that the trustee give notice that any additions may have been made to the trust. *Id.* Furthermore, contributions were often made so late in the year that it would have been nearly impossible for the beneficiaries to make a withdrawal, even assuming they had been aware of their ability to do so and that there had been a contribution to the trust. *Id.*

tax.¹⁴⁵

TAM 9628004 also explained the circumstances under which a beneficiary will be considered to have had the lawful right to withdraw corpus or income from a trust.¹⁴⁶ Through the memorandum, the government stated:

The [Internal Revenue] Service does not contest annual gift tax exclusions for *Crummey* powers held by current income beneficiaries and persons with vested remainder interests. These individuals have current or long term economic interests in the trust and in the value of the corpus. It is understandable that in weighing these interests, they decide not to exercise their withdrawal rights.¹⁴⁷

Based on the language of TAM 9628004, the Internal Revenue Service has indicated that it will challenge the use of the *Crummey* power only when the substance of the transfer clearly indicates that the donor's purpose in making the gift is to obtain the section 2503(b) annual exclusion and not to benefit the recipient.¹⁴⁸ By expressly stating the circumstances under which it will deny the use of the *Crummey* power, the government is indicating that its "substance over form" approach will only apply when the [demand rights] beneficiaries have no interest in the trust or remote contingent interests in the remainder.¹⁴⁹ Assuming that the government will disallow the use of the *Crummey* power in these limited circumstances, trust arrangements similar to those found in *Cristofani* and *Crummey* may still lawfully use the *Crummey* power.¹⁵⁰ As a result, it appears that the government will challenge the use of the *Crummey* power only when it appears that the taxpayer's primary purpose for contributing to the trust is to gain the benefit of the section 2503(b) annual gift exclusion rather than to grant the beneficiary the present ability to enjoy the trust property.¹⁵¹

2. Summary

The Internal Revenue Service's attack on the use of the *Crummey* power in conjunction with section 2503(b) is based

145. Tech. Adv. Mem. 9628004 (July 12, 1996).

146. *Id.*

147. *Id.*

148. Pennell, *supra* note 142, at 20.

149. *Id.*

150. *Id.*

151. *Id.*

on the assertion that the substance rather than the form of section 2503(b) should govern the availability of the annual gift exclusion.¹⁵² Invoking the "substance over form" approach,¹⁵³ the Internal Revenue Service has specifically attacked claimed exclusions via the *Crummey* power held by contingent remainder beneficiaries.¹⁵⁴ The Service has conceded that it will not contest annual gift tax exclusions for the *Crummey* power held by current income beneficiaries and persons with vested remainder interests.¹⁵⁵ Conversely, the Service has indicated that future annual gift exclusions via the *Crummey* power will be subject to much stricter scrutiny.¹⁵⁶

The decision by the Internal Revenue Service to challenge the use of the *Crummey* power is limited only to specific trust arrangements.¹⁵⁷ Consequently, the Service has taken a strict position regarding the use of the *Crummey* power by indicating that it will challenge the use of the *Crummey* power in situations where beneficiaries enjoy discretionary income interests, remote rights to the remainder, or no rights to the remainder at all.¹⁵⁸ Through TAM 9628004, the Service has stated that when a beneficiary enjoys only a limited interest in the trust property, there must be a prearranged understanding between the donor and the beneficiary that any of the limited rights a beneficiary has are not to be exercised.¹⁵⁹ As a result, use of the section 2503(b) annual exclusion may be denied when a beneficiary has a limited interest in the trust property.¹⁶⁰

The publication of TAM 962800 has rendered future use of the section 2503(b) annual gift exclusion via the *Crummey* power uncertain.¹⁶¹ Although the Service has indicated that it will challenge the section 2503(b) annual gift exclusion in specific trust arrangements, the Service has also stated that it will not challenge the use of the section 2503(b) annual ex-

152. See discussion *supra* Part II.E.1.

153. See discussion *supra* Part II.E.1.

154. Tech. Adv. Mem. 9628004 (July 12, 1996).

155. *Id.*

156. *Id.*

157. See discussion *supra* Part II.E.1.

158. Tech. Adv. Mem. 9628004 (July 12, 1996).

159. *Id.*

160. *Id.*

161. *Id.*

clusion via the *Crummey* power as long as the power holder is a current income beneficiary or an individual with a vested remainder interest.¹⁶² Rather, the Service has indicated that it will challenge only those cases where the beneficiary has either a very remote contingent remainder or no interest at all in the corpus or income of the trust.¹⁶³

III. IDENTIFICATION OF THE PROBLEM

The problem created by the leveraged use of the section 2503(b) annual exclusion via the *Crummey* power is that even if taxpayers adhere to the language of the Internal Revenue Code and precedent interpreting it, the Internal Revenue Service still threatens that their use of the section 2503(b) annual exclusion may be denied under some circumstances. The underlying concern of the Internal Revenue Service is that through the *Crummey* and *Cristofani* interpretations of section 2503(b), a donor taxpayer has the ability to increase his or her federal gift tax exclusions in proportion to the number of beneficiaries named in the trust instrument.

Consider the following hypothetical: Donor A has created an irrevocable living trust in which she wants to contribute \$80,000 annually. Although Donor A's primary intention in creating the trust is to benefit her three children, she will only be able to exclude \$30,000 from federal gift tax under section 2503(b).¹⁶⁴ Assuming Donor A has five or more grandchildren, she could name five of her grandchildren as contingent remainders and exclude the entire \$80,000 contribution to the trust from gift tax under the *Crummey* and *Cristofani* decisions as long as the contributions are considered gifts of a present interest.¹⁶⁵

Individuals proposing to create irrevocable living trusts will likely seek advice as to the Internal Revenue Service's current treatment of section 2503(b) and which requirements must be met in order to take full advantage of the section 2503(b) annual gift exclusion. Although it appears that the

162. *Id.*

163. *Id.*

164. I.R.C. § 2503(b) (1997). Under section 2503(b), Donor A would have the ability to exclude \$10,000 from federal gift tax for each named beneficiary. *Id.* As a result, Donor A would be able to exclude a total of \$30,000 from federal gift tax because she has named three beneficiaries. *Id.*

165. See discussion *supra* Part II.D.1.

Service is currently allowing donors to take the section 2503(b) annual exclusion as long as the contribution is considered a gift of a present interest, the Service has expressly indicated that it intends to limit the liberal treatment of the taxpayer use of the section 2503(b) annual exclusion via the *Crummey* power.¹⁶⁶

Donor taxpayers should be confident that use of the section 2503(b) annual exclusion will be allowed under the current standard set forth in *Crummey* and *Cristofani* when planning their estates. Current treatment of the section 2503(b) annual exclusion should be adhered to by the Internal Revenue Service since many taxpayers have already planned their estates in accordance with the *Crummey* and *Cristofani* decisions.¹⁶⁷ Furthermore, because of the motivation of most taxpayers in creating a trust, it is unlikely that section 2503(b) will be subject to abuse.¹⁶⁸ As a result, the donor taxpayer seeking the section 2503(b) annual gift exclusion should be left only with the duty of ensuring that any contribution to a trust be deemed a gift of a present interest, irrespective of whether there is an agreement between the donor and the beneficiary regarding the beneficiary's ability to make a present demand of trust property.¹⁶⁹

IV. ANALYSIS

A. *Is the Knowledge and Capability of the Beneficiary to Withdraw Trust Property Necessary to Use the Section 2503(b) Annual Gift Exclusion?*

This section first analyzes whether a donor's ability to use the *Crummey* power to exclude contributions to a trust is dependent upon whether the beneficiaries are aware that they have the ability to make a present demand of trust property.¹⁷⁰ Precedent concerning the use of the section 2503(b) annual exclusion implies that the Internal Revenue Service does not require that the beneficiary be informed of

166. See discussion *supra* Part II.E.1.

167. See discussion *infra* Part IV.C.1.

168. See discussion *infra* Part IV.C.2.

169. See discussion *infra* Parts IV.A-B.

170. See e.g., *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

his or her ability to make a present demand of trust property.¹⁷¹ An examination of the Service's most recent treatment of the use of section 2503(b) reveals that a donor may still take the section 2503(b) annual exclusion even when the beneficiary is not aware that she has a right to demand trust property.¹⁷² Consequently, a donor has no legal obligation to expressly inform or make known to a beneficiary of his or her right to make a present demand of contributed trust funds when using the section 2503(b) annual gift exclusion via the *Crummey* power.

In *Crummey*, the court speculated that there was a probability "that some, if not all, of the beneficiaries did not know that they had the [present ability] to demand funds from the trust."¹⁷³ The court further reasoned that it was likely that the beneficiaries did not know when contributions had been made to the trust nor in what amounts the contributions had been made.¹⁷⁴ The *Crummey* court then concluded that even if the beneficiaries had known that contributions were being made to the trust, most of the contributions were made so late in the year that the time allotted to the beneficiaries to make a demand of the trust funds was severely limited.¹⁷⁵ If the beneficiary did not exercise his right to make a present demand of trust property by December 31st of the year in which the transfer was made, the beneficiary could no longer exercise his right to the lesser amount of the transfer made in that year, or \$4,000.¹⁷⁶ Consistent with the court's assessment that the beneficiaries were likely unaware of their ability to make a present demand of trust property, none of

171. See e.g., *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968); *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601 (1956).

172. *Cristofani*, 97 T.C. at 83.

173. *Crummey*, 397 F.2d at 88.

174. *Id.*

175. *Id.* at 88. The key provision of the trust agreement in *Crummey* stated:

With respect to such additions, each child of the trustors may demand at any time (up to and including December 31 of the year in which a transfer to his or her Trust has been made) the sum of Four Thousand Dollars (\$4,000.00) or the amount of the transfer from each donor, whichever is less, payable in cash immediately upon receipt by the Trustee of the demand in writing and in any event, not later than December 31 in the year in which such transfer was made.

Id. at 83.

176. *Id.* at 83-85.

the four beneficiaries had ever made a demand under the provision, nor had any distributions been made at the time of the Ninth Circuit's decision.¹⁷⁷ Thus, it is evident from the *Crummey* decision that the presence of an express agreement between the donor and the beneficiary regarding the beneficiary's ability to make a present demand of trust funds need not exist for the donor to utilize the section 2503(b) annual gift exclusion.¹⁷⁸

Cristofani lends further support to the notion that there does not have to be an express understanding between the donor and the beneficiary regarding the beneficiary's ability or inability to make a present demand of trust property.¹⁷⁹ In *Cristofani*, there was no agreement or understanding between the donor and beneficiaries that the beneficiaries would not exercise their withdrawal rights following a contribution to the trust by the donor.¹⁸⁰ As in *Crummey*, none of the beneficiaries in *Cristofani* exercised their right to withdraw trust funds, nor were any funds distributed to the beneficiaries under the trust agreement.¹⁸¹ It may be implied from the holding of *Cristofani* that the presence of an express agreement between the donor and the beneficiary regarding the ability of the beneficiary to make a present demand of trust funds is not necessary for the donor to take the section 2503(b) annual gift exclusion for contributions made to the trust.¹⁸²

Based on the identical holdings and similar trust arrangements found in *Crummey* and *Cristofani*, it is evident that the existence of an express agreement between the do-

177. *Crummey*, 397 F.2d at 88.

178. *Id.* at 88. The *Crummey* court concluded that the petitioners should be allowed all of the section 2503(b) exclusions claimed during the two year period in question. *Id.*

179. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 77, 83 (1991).

180. *Id.*

181. *Cristofani*, 97 T.C. at 76-77. The beneficiaries in *Cristofani* were the donor's five grandchildren who had contingent remainder interests in the trust. *Id.* at 75-76. Although none of the Beneficiaries exercised their right to withdraw funds from the trust, "Article Twelfth" of the Trust required that the trustee notify the beneficiaries of the trust each time a contribution to the trust was received. *Id.* at 76.

182. *Id.* at 83-84. The *Cristofani* court allowed the petitioner to take the section 2503(b) annual exclusion with respect to each of Donor's grandchildren for each one-third interest in the "Spring Street property" transferred to the trust. *Id.* at 84-85.

nor and the beneficiary regarding the beneficiary's ability or knowledge of the ability to make a present demand of trust property is not a prerequisite for a donor to take advantage of the section 2503(b) annual gift exclusion via the *Crummey* power.¹⁸³ In both *Cristofani* and *Crummey*, the court allowed the donor taxpayer to employ the section 2503(b) annual exclusion for each transfer of property made to the trust, even though neither trust arrangement contained language indicating an agreement between the donor, the trustee, or the beneficiaries that the beneficiaries would or would not exercise their right to make a present demand of trust property.¹⁸⁴

The decisions in *Crummey* and *Cristofani* permit a donor taxpayer to take the section 2503(b) annual gift exclusion without an express agreement between the donor and the beneficiary regarding the beneficiary's ability or inability to make a present demand for the trust property.¹⁸⁵ Furthermore, a donor may take the section 2503(b) annual gift exclusion even when the beneficiary does not know that he or she has the present ability to demand funds from the trust.¹⁸⁶

B. *What Is the Best Standard to Define a Contribution of a "Present Interest?"*

1. *The Prominent Standard: The "Right to Enjoy" Standard*

Another factor that should be considered in determining whether a donor may use the section 2503(b) annual gift exclusion via the *Crummey* power is whether or not a trust contribution constitutes a gift of a "present interest."¹⁸⁷ Precedent indicates that a determination by the Internal Revenue Service of whether a gift of a "present interest" has been made is based on whether the beneficiary has a legal right or

183. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 75-84 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 83-87 (9th Cir. 1968).

184. See *Estate of Cristofani*, 97 T.C. at 75-84; *Crummey*, 397 F.2d at 83-87.

185. See *Estate of Cristofani*, 97 T.C. at 83-84; *Crummey*, 397 F.2d at 85-88.

186. *Crummey*, 397 F.2d at 87-88.

187. Treas. Reg. § 25.2503-3. Although section 25.2503-3 of the Treasury Regulations, found in the Internal Revenue Code, defines what a future interest is (which implies what a gift of a present interest is not), precedent has established that different tests exist to determine what is a gift of a present interest. *Id.*

"right to enjoy" the property of the trust rather than the mere probability that the beneficiary will actually demand trust property.¹⁸⁸

In *Cristofani*, the United States Tax Court reiterated the standard set forth in *Perkins*, *Gilmore*, and *Crummey* to determine whether a gift of a present interest has been made to a beneficiary.¹⁸⁹ In determining whether a gift of a present interest had been made,¹⁹⁰ the *Cristofani* court strictly adhered to the "right to enjoy" standard set forth in *Crummey*.¹⁹¹

As in *Crummey*, the *Cristofani* court relied on precedent to determine whether a gift of a present interest had been made.¹⁹² Case law relied upon by the tax court in *Cristofani* to determine whether the donor would be allowed to take the section 2503(b) annual exclusion included *Perkins*, *Gilmore*, and *Kieckhefer*,¹⁹³ all of which focused mainly on whether the beneficiary has a legal, unrestricted right to trust property.¹⁹⁴

The benefit of the "right to enjoy" test is that it provides a clear guideline for determining whether a gift of a present interest has been made. Unlike the "summation of the factors" test,¹⁹⁵ the "right to enjoy" test mandates only that the intended beneficiary have the present ability to make an immediate demand of trust property.¹⁹⁶ Thus, whether a gift of a present interest has been made may be ascertained solely

188. *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 88 (9th Cir. 1968). Although the current test for present interest used by both the *Cristofani* and *Crummey* courts is whether the beneficiary had the present "right to enjoy" trust property, the Internal Revenue Service and the tax court have both hinted that other considerations may be used to determine whether a gift of a present interest has been given, such as the language of the trust agreement, when enjoyment begins, whether the beneficiary may be legally restricted in a demand for trust property, the age of the beneficiary and, if the beneficiary is a minor, whether a guardian has been appointed. *Id.* at 83-87.

189. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 80 (1991). (citing *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601 (1956); *Gilmore v. Commissioner of Internal Revenue*, 213 F.2d 520 (6th Cir. 1954); and *Crummey*, 397 F.2d at 88).

190. *Cristofani*, 97 T.C. at 83-84. In *Cristofani*, the question was whether the donor's \$70,000 contribution of property to the trust in 1984 and 1985 constituted a gift of a present interest to her five grandchildren who each had a contingent remainder interest in the trust property. *Id.*

191. See discussion *supra* Part II.D.2.

192. *Cristofani*, 97 T.C. at 80-81.

193. *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118 (7th Cir. 1951).

194. *Id.* at 122.

195. See discussion *supra* Part II.D.4.

196. See *supra* note 91 and accompanying text.

from the language of the trust instrument.¹⁹⁷ Compared to the “summation of the factors” test,¹⁹⁸ the “right to enjoy” test provides a clear and identifiable means for which to determine whether a trust contribution may be considered a gift of a present interest.¹⁹⁹

a. *The Significance of the Beneficiary’s “Right to Enjoy” in Comparison to Other Factors*

With regard to trust arrangements which give the beneficiary the unqualified right to demand trust property, it may be concluded that under no circumstances may a trustee withhold payment of trust property.²⁰⁰ The *Kieckhefer* decision illustrates the weight allotted to the beneficiary’s absolute right to make a present demand of trust property and to presently use, possess, or enjoy trust property even when a trust instrument grants the trustee unfettered discretion over the distribution of trust income.²⁰¹

In *Kieckhefer*, the Seventh Circuit reasoned that “it is not, however, the use, possession, or enjoyment by the beneficiary which marks the dividing line between a present and future interest, but it is the right conferred upon the beneficiary to such use, possession, or enjoyment.”²⁰² The court’s reasoning signifies the importance the court will place on a beneficiary’s legal ability to make a present demand of trust property and to presently use or possess such property.²⁰³ It is likely that the Internal Revenue Service will allow the use

197. If the trust instrument expressly states that a beneficiary has the unrestricted, legal right to make a present demand of trust funds, a gift of a present interest will be deemed to have been made. See e.g., *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968); *Gilmore v. Commissioner of Internal Revenue*, 213 F.2d 520 (6th Cir. 1954).

198. See discussion *supra* Part II.D.4.

199. The “summation of the factors” test requires that the court take into account many different factors and make subjective conclusions regarding the donor’s intent in determining whether a gift of a present interest has been made. See discussion *supra* Part II.D.4.

200. *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118, 120 (7th Cir. 1951). If the trust instrument gives the beneficiary the absolute right to make an immediate demand of trust property, the trustee, even if granted unfettered discretion over the distribution of the trust funds, may not refuse to grant the beneficiary’s demand of trust funds. *Id.*

201. *Id.* at 118.

202. *Id.* at 121.

203. *Id.*

of the section 2503(b) annual exclusion via the *Crummey* power in trust arrangements where the trust instrument specifically indicates that the beneficiary has a vested right to the trust property *and* the present ability to use, possess, or enjoy such property.²⁰⁴

b. *An Alternative Method of Determining Whether a Gift of a Present Interest Has Been Made*

Similar to the *Gilmore* "right to enjoy" test, the *Perkins* decision established that a donor will have made a gift of a present interest so long as that donor cannot legally resist a beneficiary's demand of trust property.²⁰⁵ Implicit in *Perkins* is the assumption that the language of the trust instrument is critical in the court's determination of whether a donor may employ the section 2503(b) annual gift exclusion.²⁰⁶

As shown by the facts presented in *Crummey*, a child could inform the trustee that she is demanding trust property as long as the demand is pursuant to language in the trust instrument.²⁰⁷ In such a case, the trustee would petition the court for the appointment of a legal guardian (likely the parent of the beneficiary) and turn the funds over to the guardian.²⁰⁸ The *Crummey* court also indicated that it may be possible for a parent of a beneficiary to make a demand of the trust funds as a legal guardian pursuant to language contained in the trust instrument.²⁰⁹ Similarly, in *Cristofani*, the trust instrument expressly indicated that both the primary beneficiaries, as well as those beneficiaries named in the trust with contingent remainder interests, had the ability to make a present demand from the trust.²¹⁰

204. *Fondren v. Commissioner of Internal Revenue*, 324 U.S. 18, 20 (5th Cir. 1944). The Fifth Circuit decision in *Fondren* illustrates the position taken by the I.R.S. that use of the 2503(b) annual gift exclusion will be dictated by when the beneficiary can enjoy the property, not when the beneficiary's legal right to the property has vested. *Id.* The *Fondren* court implied that if a trust instrument causes there to be a substantial period of time between the will of the beneficiary to enjoy the property and the beneficiary's actual enjoyment of the trust property, the trust contribution will likely be considered a gift of a future interest. *Id.* at 20, 21.

205. *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601, 606 (1956).

206. *Id.* at 604-06.

207. See *supra* notes 46-48 and accompanying text.

208. *Crummey*, 397 F.2d at 87.

209. *Id.* at 87.

210. *Id.* at 76. Under "Article Twelfth," each of the five grandchildren with contingent remainder interests were granted the express right to withdraw an

c. *Summary of the "Right to Enjoy" and Legal Right Tests*

The trust instruments in *Cristofani*, *Crummey*, and *Perkins* each contained language which expressly gave the beneficiary the right to make a present demand of trust property.²¹¹ In all three cases, the court determined that contributions made to each respective trust were gifts of a present interest, allowing the donor to take the section 2503(b) annual gift exclusion for all beneficiaries named in each trust.²¹²

It is evident from the similar conclusions reached by the courts in *Perkins*, *Crummey*, and *Cristofani* that language contained in a trust instrument expressly granting a beneficiary or the beneficiary's legal guardian the right to make a present demand of trust property is a significant factor in determining whether a contribution may be deemed a gift of a present interest.²¹³ While each trust arrangement is different, precedent dictates that if the trust instrument grants the beneficiary the immediate "right to enjoy" trust property, it is likely that any contribution to the trust will be deemed a gift of a present interest.²¹⁴ Often, the donor has created and contributed to the trust with the goal of avoiding federal estate tax liability.²¹⁵ However, even when the motive of the donor is to avoid tax liability, current treatment by the Internal Revenue Service of taxpayer use of the *Crummey* power mandates that as long as the beneficiary has the present "right to enjoy" trust property, any contribution to a trust will be considered a gift of a present interest.²¹⁶ Subsequently, a donor expressly indicating through a trust instrument that a beneficiary has a vested right to the property of

amount not to exceed the amount specified for the gift tax exclusion under section 2503(b) (\$10,000) as long as the demand for trust funds was made fifteen days following a contribution to the trust. *Id.*

211. See *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 75-77 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82, 83-87; *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601, 602-604 (1956).

212. See *Estate of Cristofani*, 97 T.C. at 84-85; *Crummey*, 397 F.2d at 88; *Perkins*, 27 T.C. at 606.

213. See *Estate of Cristofani*, 97 T.C. at 84; *Crummey*, 397 F.2d at 88; *Perkins*, 27 T.C. at 604-06.

214. See, e.g., *Perkins*, 27 T.C. at 601; *Crummey*, 397 F.2d at 82; *Estate of Cristofani*, 97 T.C. at 74.

215. *Perkins*, 27 T.C. at 605-06.

216. *Id.*

the trust, as well as the right of immediate enjoyment, will likely be allowed to utilize the section 2503(b) annual gift exclusion via the *Crummey* power.

2. A Second Test: "Summation of the Factors"

A second test employed by the courts to determine whether a trust contribution is considered a gift of a present interest is the "summation of the factors" test.²¹⁷ However, an examination of current precedent involving the section 2503(b) annual gift exclusion reveals that rarely, if at all, is the "summation of the factors" test still utilized by the courts in determining whether a gift of a present interest has been made.²¹⁸ *Stifel v. Commissioner*²¹⁹ illustrated some of the factors which the court will take into consideration when employing the "summation of the factors" test.²²⁰ In determining whether a contribution to a trust will be considered a gift of a present interest, the *Stifel* court looked to the language of the trust instrument, including whether a minor beneficiary could make a demand in her own individual capacity, whether a guardian had been appointed, and what the circumstances surrounding the creation of the trust were.²²¹

Although similar to the trust arrangements found in *Perkins*, *Gilmore*, *Crummey*, and *Cristofani*, the court in *Stifel* denied the donor the use of the Section 1003 annual gift exclusion,²²² concluding that contributions to the trust were gifts of future rather than present interests.²²³ In deciding whether there was a substantial likelihood that the beneficiaries would actually enjoy the trust property, the court reasoned that the beneficiaries could not make a demand of trust property in their individual capacities, but, rather, only through a guardian²²⁴ and that the primary pur-

217. See discussion *supra* Part II.D.4.

218. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74, 80-81 (1991). Echoing the Ninth Circuit in *Crummey*, the *Cristofani* court rejected a test to determine present interest based on factors, such as, the trust instrument, the law as to minors, and the circumstances surrounding the formation of the trust. *Id.*

219. 197 F.2d 107 (2d Cir. 1952).

220. *Id.* at 110.

221. See discussion *supra* Part II.D.4.

222. Section 1003 is the 1952 equivalent of the current section 2503(b) annual gift exclusion. I.R.C. § 2503(b) (1997).

223. *Stifel*, 197 F.2d at 111.

224. See discussion *supra* Part II.D.4.

pose behind the creation of the trust was to help the beneficiaries learn how to invest their money and not to aid in their support.²²⁵ Considering the language of the trust instrument, the age of the beneficiaries, and, most importantly, the circumstances surrounding the creation of the trust, the *Stifel* court concluded that the contributions to the trust were gifts of a future interest.²²⁶

3. Integrating the "Right to Enjoy" and "Substantial Likelihood" Tests

The factual basis of *Stifel* is similar to many of the cases previously discussed under the "right to enjoy" test.²²⁷ In determining whether a gift of a present interest has been made, it is crucial that the court not employ a single test. Rather, an integration of the "right to enjoy"²²⁸ test and the "summation of the factors"²²⁹ test will provide the most effective means for determining whether a gift of a present interest has been made.

A proper integration of the "summation of the factors" and the "right to enjoy" tests is illustrated through the decision in *Stifel*.²³⁰ In addition to the language of the trust instrument and the circumstances surrounding the creation of the trust, the *Stifel* court considered the need for the beneficiary to have a legal right to the trust property, *as well as* the present right to enjoy or possess such property.²³¹ As in *Kieckhefer*, the *Stifel* court adhered to the proposition that no gift to a minor would be considered tax-free if the minor's legal right to enjoy the gifted property was the only test for present interest.²³² In construing the above proposition, the *Stifel* court concluded that, although the minor beneficiaries had a legal right to the trust property, they did not have the ability to presently enjoy or possess any of the trust funds.²³³

225. See discussion *supra* Part II.D.4.

226. *Stifel v. Commissioner of Internal Revenue*, 197 F.2d 107, 111 (2d Cir. 1952).

227. See discussion *supra* Part IV.B.1.

228. See discussion *supra* Part IV.B.1.a-b.

229. See discussion *supra* Part IV.B.2.

230. *Stifel*, 197 F.2d at 110.

231. See discussion *supra* Part IV.B.1.a.

232. *Stifel v. Commissioner of Internal Revenue*, 197 F.2d 107, 110 (citing *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118, 122 (7th Cir. 1951)).

233. *Stifel*, 197 F.2d at 110-11.

Because the minors, in their individual capacities, could not make a present demand of the trust property and no guardian had been appointed to exercise this right for them, there was no one who could exercise their election rights on their behalf and the minors were deemed to have acquired only future interests in the trust property.²³⁴

Although the "right to enjoy" or legal right test is the better single test for determining whether a gift of a present interest has been made, the *Stifel* decision lends support to the notion that the donor taxpayer should consider employing both the "summation of the factors" test and the "right to enjoy" or legal right test in determining whether a trust contribution will be considered a gift of a present interest. Once a trust contribution is considered a gift of a present interest, the donor taxpayer will be allowed to take the section 2503(b) annual gift exclusion.²³⁵

C. *Policy Considerations: Factors Against the Internal Revenue Service's More Stringent Treatment of Section 2503(b)*

1. *Taxpayer Reliance on the Current Treatment of Section 2503(b)*

Another factor that supports the Internal Revenue Service's current interpretation of the section 2503(b) annual gift exclusion is the effect which increased scrutiny of the annual gift exclusion will have on estate planning done in accordance with the *Crummey* and *Cristofani* decisions. Specifically, increased scrutiny by the Service with regard to the use of the section 2503(b) annual gift exclusion will have the most significant impact on those taxpayers who have already planned their estates in accordance with the *Crummey* decision.²³⁶

Taxpayers who created trust arrangements prior to the publication of TAM 9628004 did so in accordance with precedent interpreting the extent to which the section 2503(b) annual exclusion could be used. If the Service does not acquiesce in its "substance over form" approach limiting the use of the section 2503(b) annual exclusion,²³⁷ those taxpayers who

234. *Id.*

235. I.R.C. § 2503(b) (1997).

236. See discussion *supra* Part I.

237. See discussion *supra* Part II.E.1.

have already created trust arrangements in reliance on the *Crummey* and *Cristofani* decisions will be most seriously affected.

The Internal Revenue Service invokes its "substance over form" approach by asserting that inaction by beneficiaries in exercising their right to withdraw trust property implies that there was a prearranged agreement between the donor and the beneficiaries that the beneficiaries would not exercise their right to withdraw trust funds.²³⁸ The Service's proposal will force those taxpayers who have relied on the court's decisions in *Crummey* and *Cristofani* to revamp their existing federal tax scheme.²³⁹ Because many of the tax schemes of those taxpayers who have created trusts involve scheduled contributions to the trust, the effect of the Service's proposal would be to alter the taxpayer's contributions to the trust or to halt the contributions altogether. Taxpayers who previously relied on the section 2503(b) annual exclusion may now be forced to either terminate the trust or alter their trust contributions in order to maximize federal tax planning in accordance the Service's new position regarding the use of section 2503(b) via the *Crummey* power.²⁴⁰

Taxpayers who lawfully created trust arrangements in accordance with section 2503(b) of the Internal Revenue Code and the decisions in *Crummey* and *Cristofani* prior to the publication of TAM 9628004 face potential problems.²⁴¹ Because these individuals planned their estate in accordance with the federal gift tax law at the time the trust was created, the Service's retroactive limitation of the use of section 2503(b) would likely negate the benefits of the taxpayers' current tax scheme. In accordance with TAM 9628004, the Service could disallow the section 2503(b) annual gift exclusion for a beneficiary who has only a discretionary income or remote contingent remainder interest in the trust.²⁴² Because the Service would have previously allowed a section 2503(b) exclusion for the beneficiary and the donor taxpayer had re-

238. See discussion *supra* Part II.E.1.

239. See discussion *supra* Part II.E.1.

240. See discussion *supra* Part II.E.1.

241. Taxpayers employing section 2503(b) needed only to abide by the decisions in *Crummey* and *Cristofani* to lawfully take the annual gift exclusion. See *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968).

242. See discussion *supra* Part II.E.1.

lied on this exclusion, the Service's new proposal would cause an unwarranted increase in the donor taxpayer's federal gift tax liability.²⁴³

2. *Abuse of the Section 2503(b) Annual Gift Exclusion Through the Crummey Power*

A second policy consideration supporting a *Crummey* interpretation of the annual gift exclusion is the frequency and degree of taxpayer abuse to which section 2503(b) is currently subjected.²⁴⁴ Should the Internal Revenue Service continue to allow the donor to take advantage of the section 2503(b) annual gift exclusion via the *Crummey* power in trust arrangements where it objectively appears²⁴⁵ that the donor intended a beneficiary to have a present interest in the trust property, taxpayer abuse of the section 2503(b) annual exclusion will be unlikely.

However, the possibility that the section 2503(b) annual exclusion may be subject to abuse when applied through the *Crummey* and *Cristofani* decisions is a major factor in the Service's "substance over form" attack on the current use of the section 2503(b) annual exclusion.²⁴⁶ The proposed challenge of the use of section 2503(b) is based on a concern by the Internal Revenue Service that the current use of section 2503(b), as interpreted through *Crummey* and *Cristofani*, allows donor taxpayers to name beneficiaries in relation to the amount annually contributed to the trust.²⁴⁷ Lawful use of

243. See discussion *supra* Part II.E.1.

244. See discussion *supra* Part I.

245. *Heyen v. United States*, 945 F.2d 359 (10th Cir. 1991). In determining whether a donor has transferred a taxable gift to the donee, the subjective intent of the donor at the time of the transfer is not an important factor in determining whether the donor has made a gift. *Id.* at 361. Rather, determination of whether a taxable gift has been made is based primarily on the objective facts and circumstances under which the transfer is made. *Id.*

246. Owen G. Fiore et al., *Is the End in Sight for Crummey/Cristofani Trusts*, TAX ADVISOR ALERT MEMORANDUM, Sept. 1996, at 11.

247. *Estate of Cristofani v. Commissioner of Internal Revenue*, 97 T.C. 74 (1991); *Crummey v. Commissioner of Internal Revenue*, 397 F.2d 82 (9th Cir. 1968); *Perkins v. Commissioner of Internal Revenue*, 27 T.C. 601 (1956); *Gilmore v. Commissioner of Internal Revenue*, 213 F.2d 520 (6th Cir. 1954). Under the standard set forth in *Crummey* and *Cristofani*, the major requirement for taking the section 2503(b) exclusion is that the beneficiary receive a gift of a present interest. As a result, the donor could theoretically name as many beneficiaries as necessary to have the effect of excluding the entire amount of each contribution from federal gift tax.

section 2503(b) only requires that contributions to the trust by the donor taxpayer be considered gifts of a present interest.²⁴⁸

Although minimizing federal gift tax liability does provide motivation for creating trusts,²⁴⁹ another powerful reason for creating trusts is to benefit those beneficiaries named in the trust instrument. In most circumstances, trusts are created by a parent or grandparent with the intent of benefiting their children, grandchildren, or both. Using the trust as a medium, the donor taxpayer can make inter vivos transfers while retaining some degree of control over who is to benefit from the trust, when distributions are to be made from the trust, and tax concerns which may arise in connection with the trust.²⁵⁰ Although the trust agreement may be altered, the result of naming more beneficiaries to a trust is to distribute the right to the income and corpus of the trust to more individuals. Subsequently, each beneficiary will enjoy a smaller percentage of the trust property. Because the primary motivation of the donor taxpayer will be to provide specific beneficiaries with the right to a predetermined amount of trust property, it is unlikely that the donor will increase the number of beneficiaries named in a trust instrument solely to take advantage of section 2503(b) through the *Crummey* power. Hence, when considering the primary motivation of the donor taxpayer in creating the trust, the Internal Revenue Service's concern over the perceived abuse of section 2503(b) is unfounded.²⁵¹

V. PROPOSAL: SUGGESTED LEGISLATION FOR THE SECTION 2503(b) ANNUAL EXCLUSION VIA THE *CRUMMEY* POWER

The following framework codifies the requirements set forth in the *Crummey* and *Cristofani* decisions interpreting section 2503(b) as the "Section 2503(b) Annual Exclusion Parameters." These Parameters will aid courts in determining whether the section 2503(b) annual exclusion has been lawfully used in trust arrangements. Furthermore, the below framework could also provide a guideline for donor taxpayers who have created a trust and want to ensure that their use of

248. See discussion *supra* Part IV.A-B.

249. See discussion *supra* Part IV.B.1.c.

250. Fiore & Ramsbacher, *supra* note 7, at 10.

251. *Id.*

the section 2503(b) annual exclusion will not be challenged by the Internal Revenue Service:

Section 2503(b) Annual Exclusion Parameters.

(A) For purposes of taking the \$10,000 annual exclusion in relation to *either* present or contingent beneficiaries pursuant to section 2503(b) of the Internal Revenue Code, the taxpayer must meet the following requirements:

(1) Each trust contribution must be a gift of a present interest.²⁵²

(a) A trust contribution will be considered to be a gift of a present interest *only when*:

(i) the beneficiary has a legal vested right in the property of the trust *and* has the present ability to enjoy or possess the property of the trust upon demand²⁵³ *or*

(ii) the different factors of the trust arrangement indicate that a gift of a present interest has been made *and* the beneficiary has a legal vested right in the property of the trust *and* has the present ability to enjoy or possess the property of the trust upon demand.²⁵⁴

(2) The taxpayer's primary purpose for creating the trust is to benefit a predetermined number of individuals named in the trust at the time the trust is created.²⁵⁵

(B) In determining whether section 2503(b) of the Internal Revenue Code may be used, the existence of an express agreement between the donor and the beneficiary regarding the beneficiary's right to withdraw trust property shall not be controlling.²⁵⁶

252. This idea is taken directly from section 2503(b) of the Internal Revenue Code. This language is placed in the proposed legislation because section 2503(b) mandates that a gift of a present interest be made if the annual exclusion is to be taken. I.R.C § 2503(b) (1997).

253. See, e.g., *Kieckhefer v. Commissioner of Internal Revenue*, 189 F.2d 118 (7th Cir. 1951); see also *supra* Part IV.B.1.a. for a discussion of this guideline.

254. See discussion *supra* Part IV.B.3.

255. This requirement is taken directly from the policy considerations surrounding the use of section 2503(b) via the *Crummey* power. See discussion *supra* Part IV.C.2.

256. See discussion *supra* Part IV.A.

VI. CONCLUSION

The publication of TAM 9628004 illustrates the inability of the Internal Revenue Service to completely accept the *Crummey* and *Cristofani* interpretations of the section 2503(b) annual exclusion.²⁵⁷ The conflicting treatment of section 2503(b) by TAM 9628004 and prior case law obviates the need for new legislation to guide taxpayers on the use of the section 2503(b) annual exclusion.²⁵⁸ With trust arrangements continuing to be created by taxpayers employing the section 2503(b) annual exclusion, determining whether the section 2503(b) annual exclusion has been properly used will become more problematic for taxpayers who want to rely on this section in planning their estates. As a result, legislation must be developed to solidify all the requirements that must be met to lawfully use the section 2503(b) annual exclusion.²⁵⁹

This comment combines specific requirements set forth in prior case law with the policy concerns of the Internal Revenue Service to establish a framework for determining lawful use of the section 2503(b) annual exclusion.²⁶⁰ Each trust arrangement in which the section 2503(b) annual exclusion will be used is apt to differ. Nevertheless, taxpayer adherence to the requirements set forth in this comment can help ensure that use of the section 2503(b) annual exclusion will not be contested by the Internal Revenue Service.

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257. See discussion *supra* Part II.E.1.

258. Prior to 1996, the *Crummey* and *Cristofani* decisions served as a guideline for taxpayers taking the section 2503(b) annual exclusion. See discussion *supra* Parts II.B-C. However, in 1996, the Internal Revenue Service threatened to challenge the use of the section 2503(b) annual exclusion via the *Crummey* power when beneficiaries with discretionary income or remote contingent interests in the trust property had not exercised their rights to the trust property. See discussion *supra* Part II.E.1. The Internal Revenue Service justified this assertion by implying a prearranged understanding between the donor and the beneficiaries that the beneficiaries would not exercise their right to the trust property. See discussion *supra* Parts II.E.1.

259. See discussion *supra* Part V.

260. See discussion *supra* Part V.

* * *